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Co-op lawsuit ends in settlement for farmers

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Three years after eight Kentucky tobacco growers filed a lawsuit against the Burley Tobacco Growers Cooperative Association (Co-op), the fight is finally drawing to a close.

Though headlines have touted that tobacco farmers will receive \$130 million in the settlement of the suit, the case itself tells a different story.

The history of the Co-op

The Co-op is a nonprofit, agricultural marketing cooperative that was founded in 1922 to provide a voice for the small tobacco farmer. In 1940, with the inception of the federal tobacco price support program, the Co-op's principal purpose became the administration of the federal tobacco price support program for the benefit of its producer members.

Each year, the Co-op borrowed funds from the Commodity Credit Corporation (CCC) to make the initial advance payments to the producer members for tobacco they could not sell at market. The Co-op would then process and store the tobacco pool crop — unsold tobacco — on behalf of the producer members as collateral for a crop year loan from CCC.

If the Co-op sold the pool tobacco at a profit, a distribution payment was made back to farmers in accordance to the marketing agreement. If not, the government covered the losses at no cost to the farmer or the Co-op.

In 1982, Congress passed the No Net Cost Act, with the goal that the government would no longer use public money to cover yearly losses of the tobacco price support program. It was then the responsibility of the Co-op and farmers to retain funds each year to cover potential losses, the "NNC funds."

In 1986, a special agreement was brokered by Congress with the four major cigarette manufacturers to purchase the problematic '82 loan pool crop "at cost" from the CCC. The companies were required to pay all of the Co-op's associated tobacco loans and expenses at a fixed interest rate over five years.

In 1990, the Co-op Board voted to purchase the remaining '82 loan pool stocks from the CCC at a lower interest rate. The Co-op sold the remaining stocks to the companies under the '86 agreement and after repaying its loan netted a before-tax profit of about \$25 million from the float, or difference between the interest rates.

The Co-op Board retained the \$25 million in reserves to assist with new challenges faced in the tobacco industry and to cover future losses associated with the loan pool crops.

In 2004, Congress ended the federal tobacco price support program and the public auction system of selling tobacco by passing the buyout.

The buyout legislation directed the CCC to call due all outstanding tobacco loans and take possession of the tobacco “pool stocks,” which were collateral for the loans. NNC funds were used to pay off the crop year loans, and millions of pounds of burley tobacco were returned to the Co-op and other associations for disposal.

The lawsuit

In December 2003, eight Kentucky farmers filed a lawsuit in Fayette District Court against the Co-op for its failure to distribute to members the alleged net profits from the sale of 1982 tobacco loan pool purchased from the CCC.

Their claim as plaintiffs was that Co-op breached its contractual duty to distribute the \$25 million profit to all holders of the ‘82 participation certificates.

In the suit, the plaintiffs also claimed several counts of abuse by the Co-op, including breach of fiduciary duty, conversion, negligent misrepresentation, breach of constructive trust/resulting trust and demanded a disillusion of the Co-op.

Subsequent to the filing of the lawsuit, Congress passed the buyout, and the Plaintiffs filed an amendment to the original suit. In the amendment, they sought either compensation or a distribution of net profits or a capital distribution from the sale of the buyout tobacco, on their behalf and on behalf of the punitive class members.

The recent rulings

On February 13, Judge Goodwine entered an opinion on the plaintiffs’ class action status for the 1982 proposed class and the proposed 1983-2004 classes.

In the opinion, the court stated it shared concerns expressed in a testimony by John Berry, former president of the Co-op, including irreconcilable conflicts between the ‘82 Class and the ‘83-04 Class.

The opinion also stated that 111 members of the Co-op have given affidavits opposing this lawsuit, including members from Indiana, Missouri, West Virginia, Ohio and Kentucky.

The court concluded in the opinion that the class action mechanism is not superior to other available methods for the fair and efficient adjudication of this action. Thus the judge vacated the district court order granting certification of the 1982 class in June 2005 and overruled the plaintiffs’ motion to certify the 1983-2004 class.

Then on March 13, Judge Goodwine ruled in an opinion and order on the plaintiffs’ contract claim to the \$25 million, which resulted from the sale of the 1982 pool stocks.

The opinion states that there was no bad faith or abuse of discretion by the directors of the Co-op in retaining the after-tax profits from “an extraordinary transaction” and that it was not a sale of tobacco in the ordinary course of business.

Judge Goodwine went on to say that the transaction is rightfully viewed as a transaction for the benefit of all Co-op members, not just a sale of pool tobacco for those growers who sold or consigned tobacco

into the '82 loan pool.

The opinion went on to state that, “The plaintiffs have no breach of contract claim nor any right to otherwise challenge this extraordinary transaction, which was completed more than ten years before named plaintiffs filed their initial action in the Fayette District Court.”

The judge dismissed the plaintiffs’ claim to the profit from the sale of the '82 loan pool.

Two days later, on March 15, Judge Goodwine ruled in an opinion and judgment on the buyout tobacco and sales proceeds of that tobacco.

In the opinion, the judge stated that once the Co-op decided to dispose of the buyout tobacco through a sale, it was contractually obligated to distribute the sales proceeds in accordance with their contractual obligation — the marketing agreement.

The Judge did note in the opinion that the Co-op did not receive the buyout tobacco until 2005, which was after the initial lawsuit had been filed.

In the opinion, the Co-op was given credit for one percent reasonable reserve from the sale of all buyout tobacco, plus reasonable costs and expenses incurred by the Co-op for handling, storing and insuring the tobacco.

The Co-op is also required to sell any remaining buyout tobacco and liquidate investments associated with the buyout funds, which are then to be disbursed to members. The Co-op shall also request a refund of income taxes paid — upon court order last June — on the proceeds from the sale of the buyout tobacco, which are to be disbursed to members as well.

In the opinion, the judge also stated that the proceeds of the buyout tobacco must be distributed to Co-op members from 2002-2004 on a per capita basis.

The judge also ruled against punitive damages being paid by the Co-op to the plaintiffs and noted in the opinion that the Court previously dismissed all tort theories alleged by the plaintiffs’ as announced on the status conference held Oct 4, 2005.

If the two parties are unable to agree upon the final amount — of the estimated \$130 million — to be disbursed to members after all deductions and credits are considered, then the judge will rule on a final disbursement to the members.

Money for the farmers

According to attorneys for both sides, there is at least a \$30 million difference in the total amount of funds the Co-op should pay out of the buyout tobacco proceeds.

On top of that, the judge has ruled that the Co-op can deduct from the amount over \$11 million in Phase II supplemental payments to states and the almost \$5 million invested in the infrastructure development program. This is on top of the one percent in fees, an estimated \$1.3 million, the Co-op may retain for handling the buyout tobacco.

Additionally, there is no guarantee that the IRS will return the over \$35 million that the court ordered the Co-op to pay last summer in taxes. Also attorney fees and other items will be deducted from the total funds awarded for distribution.

So where does that leave the almost 200,000 members that the Co-op claims?

“It certainly will be beneficial to us in terms of making it through another year,” stated Jim Barton, a Fayette County farmer and one of the plaintiffs in the suit, following the March 15 ruling. “A cooperative is supposed to work in the best interest of its members. It doesn’t matter if it’s an agricultural co-op or a utility co-op. This order does the right thing by giving farmers back their money.”

Interestingly in March 2005, according to the Co-op Board’s meeting minutes, the Board passed a resolution stating that it is hopeful it can sell the buyout tobacco and distribute some or all of the cash from the sale to its members. Those funds quickly became a part of the lawsuit filed more than a year earlier, and the Co-op Board did not develop a mechanism for disbursing the funds.

“We are caretakers of this money for the farmers,” explained Roger Quarles, president for the Co-op Board. “Our goal with the buyout tobacco proceeds has always been to be fair to our former growers, but we also wanted to keep something to provide stability to future growers.”

As it stands now, if the remaining buyout tobacco funds are disbursed on a per capita basis, “one vote — one share,” then a best-case scenario is that members might receive \$500 from this settlement. Due to issues surrounding the potential return of taxes paid by the Co-op, the payment would likely be disbursed in two separate payments over a two- to three-year period.

Would the Co-op Board have distributed a settlement of that level to the members? Would they have used the funds to provide marketing, educational and infrastructure assistance to current tobacco growers as they continue to navigate the post-buyout marketplace? At this point, these questions can only be speculative, and no one will ever know for sure.

Both the plaintiffs’ and the Co-op have their views on how the buyout tobacco proceeds would have been used if not captured as a part of the lawsuit. Yet farmers have to wonder after three years and countless hours spent on this case, if they really did win.

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